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ExParte

November 22, 1996

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W. - Room 222
Washington, D.C. 20554

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Federal Communications Commission
Office of Secretary

Re: CC Docket No. 96-150 (Accounting Safeguards Under the
Telecommunications Act of 1996)

Dear Mr. Caton:

In accordance with Commission rules, please be advised that today in separate meetings , Sherry Herauf (Pacific Telesis), Tony Alessi (Ameritech), Jerry Asch (Bell Atlantic), Mike Crumling (U S WEST), David Hatton (NYNEX), Jane Knox (SBC) and the undersigned, representing BellSouth Corporation, met with James Casserly, Senior Legal Advisor to Commissioner Ness. In the second meeting, all of the above except David Hatton representing NYNEX met with Lauren Belvin, Senior Legal Advisor to Commissioner Quello to discuss the above-referenced docket. Attached is a handout that was provided at the meeting to facilitate the discussion. The discussion was consistent with the pleadings of the represented parties already on file in this proceeding .

Please call me if you have any questions.

Sincerely,



Maurice P. Talbot, Jr.
Executive Director - Federal Regulatory

Attachment

cc: Lauren "Pete" Belvin w/o attachment
James Casserly w/o attachment

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EX PARTE
CC DOCKET NO. 96-150

**ACCOUNTING SAFEGUARDS
UNDER THE
TELECOMMUNICATIONS
ACT OF 1996**

**Ameritech, Bell Atlantic,
BellSouth, NYNEX,
Pacific Telesis, SBC, U S WEST**

November 22, 1996

PREVAILING MARKET PRICE MUST BE RETAINED AS A VALUATION STANDARD

- Sec. 272 nondiscrimination provisions require that any price at which the BOC offers an asset or service to its Sec. 272 affiliate becomes the prevailing price at which it is offered to any other entity; therefore, prevailing price must be retained in the hierarchy
- Sec. 272(b)(5) and Sec. 272(c)(1) in concert define prevailing price for transactions between a BOC and its Sec. 272 affiliate
- Transactional costs, including marketing costs, are irrelevant when considering affiliate transactions valuation due to the Sec. 272 nondiscrimination requirements; prevailing price is the same for all parties
- Neither the record nor the reasons proffered in the NPRM are sufficient to remove prevailing market price from the valuation hierarchy
- Current rules have been in effect since 1987, and have been effective in deterring and detecting abuses

AFFILIATE TRANSACTION RULES FOR SERVICES
SHOULD NOT BECOME MORE BURDENSOME

- Commission should not require estimated fair market value studies for services
- Prevailing market price valuation works well and should not be replaced by estimated fair market value
- Current rule for services should be retained, i.e. tariffed rate, else prevailing market price, else fully distributed cost
- Requiring estimated fair market value studies for services would be burdensome and unreliable
 - will be unduly costly to satisfy solely a regulatory requirement, i.e. in the absence of prevailing market price carrier would be required to do both an FDC study and an estimated fair market value study
 - decreases productivity by increasing input costs with no gain in outputs
 - anticompetitive - causes ILECs to incur costs that are not borne by competitors
 - affiliate services are generally knowledge based or highly technical and involve proprietary and sensitive business information
 - thus, many affiliate services would not be generally available on the open market and/or would not be services a business would outsource, e.g., strategic planning, investor relations, pension administration, securing capital, internal auditing, executive support, etc.

- Commission should not adopt asymmetrical rule (higher/lower) for services
 - asymmetry for service transactions not required by Act
 - nondiscrimination requirements, competition and compliance audit and review are more than sufficient safeguards to insure fair competition
 - price caps removes incentive to cross-subsidize

BIENNIAL AUDIT

- We agree with the Commission's tentative conclusion in paragraph 93 of the NPRM.
- Generally Accepted Auditing Standards (GAAS) require that an examination audit be performed when the auditor's report is required to include the auditor's opinion whether management has complied with specified rules; thus, an examination audit is called for under the Act.
- We disagree with NARUC's audit proposal because it would preclude the auditor from performing an examination audit, contradicts the tentative conclusion of the NPRM, and is contrary to the Act.

Attachment A

ESTIMATED FAIR MARKET VALUATION FOR SERVICES IS BURDENSOME AND INAPPROPRIATE

- Proposed rule change would impose unreasonable burdens with no demonstrable benefits, are expensive, unduly complex and burdensome to administer, adds substantial subjectivity that will erode auditability, discourages efficiencies, imposes a competitive disadvantage on the BOCs and will not benefit ratepayers.
- FCC Reconsideration Order 87-305 @ para131, "Several parties have argued that if a tariff or prevailing price is unavailable as a measure of value, we should look to the value of similar services in the marketplace. We believe that such a valuation is fraught with the potential for abuses, and would be difficult to monitor. In contrast, by requiring carriers and their affiliates to allocate costs pursuant to cost allocation standards, we can ensure that an auditable measure of the cost of the service is available."
- There have been no developments since the issuance of the Reconsideration Order that would make these determinations any less complex or subjective.
- The problem is there is great difficulty identifying comparable transactions in the market place and the inherent subjectivity of the estimated fair market value.
- Standard market appraisal practices call for identification of multiple comparable transactions and applying inherently subjective adjustments to account for the *fact that comparable transactions are not identical to the subject transaction*; such adjustments include but are not limited to term of contract, service availability, payment mechanism, knowledge and attentiveness of service provider and compatibility of delivery systems.

EXAMPLE:

A BOC loans an engineer to an affiliate for a two-week period. Under existing rules, the transaction could be valued using fully distributed cost. Under the proposed rule, the BOC would also have to determine the market value of the service. What appears to be a simple transaction under the current rule raises a series of relevant market valuation questions that add substantial cost and complexity to the transaction. For instance:

1. What is the market value of the job that will be performed? Is this job performed in similar businesses or other industries?
2. What is the level of required knowledge, background and required familiarity with systems, practices and documentation?
3. How does the short duration of the job affect market value?
4. Are there any comparables where individuals perform short term job without leaving their long term employer and without change in their compensation and benefits?

- The impact of requiring fair market valuations will increase the cost of doing business which potentially increases the cost to ratepayers

EXAMPLE:

A BOC provides a service today to an affiliate at tariff rate, prevailing price or fully distributed cost. If no tariff rate or prevailing price exist then the transaction takes place at fully distributed cost. As an economic matter fully distributed cost is more than sufficient to prevent cross subsidy. Therefore, there is no harm to the ratepayer.

Under the proposed rule if there is no tariff rate the transaction would take place at the higher of fair market value or fully distributed cost. Assume the cost of performing the fair market valuation is \$40,000.00. The result of the valuation is that fully distributed cost is higher. The affiliate is charged at fully distributed cost. The \$40,000, which under the current rules would not have been incurred by the company, now becomes a cost of doing business.

The result of the rule change in this example is nothing really changed, the ratepayer may be impacted through higher rates and the BOC has been competitively disadvantaged.